No. 14794

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA,

Appellant,

vs.

STAR-KIST FOODS, INC., (formerly the French Sardine Company of California),

Appellee.

On Appeal From the Judgment of the United States District Court for the Southern District of California.

BRIEF FOR THE APPELLANT.

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BRIEF FOR THE APPELLANT.

Opinion Below.

The opinion of the District Court [R. 36-49] is not officially reported.

Jurisdiction.

This appeal involves federal excess profits taxes in the amount of $111,359.02, plus interest, for the fiscal year ended May 31, 1943. Pursuant to an assessment of deficiency on January 28, 1947 [R. 25], taxpayer paid additional taxes on July 29, 1948, and filed a claim for a refund on October 14, 1949. [R. 11-12, 38.] No action on the claim for refund was taken within six months, and on February 27, 1952, the taxpayer brought an action in the District Court for recovery of the taxes paid. [R. 3-20.] Jurisdiction was conferred on the Dis-

trict Court by 28 U. S. C., Section 1346(a)(1). The District Court entered judgment in favor of the taxpayer on February 3, 1955. [R. 54-55.] Notice of appeal was filed March 30, 1955. [R. 57.] Jurisdiction is conferred on this Court by 28 U. S. C., Section 1291.

Question Presented.

Whether the amount paid by the taxpayer to the Treasurer of the United States in compromise of a treble damage claim by the Office of Price Administration under Section 205(e) of the Emergency Price Control Act of 1942, as amended, is deductible as an ordinary and necessary business expense under Section 23(a)(1)(A) of the Internal Revenue Code of 1939.

Statutes and Regulations Involved.

The pertinent statutes and Regulations involved are set forth in the Appendix, *infra.*

Statement.

The findings of fact of the court below, which, in part, the appellant contends are "clearly erroneous," may be summarized as follows:

The taxpayer was incorporated under the laws of the State of California, in November, 1917, as the French Sardine Company of California. In April, 1953, its name was changed to Star-Kist Foods, Inc. Since its incorporation, taxpayer has been engaged in the fish cannery business, having its offices and principal place of business at 181 Fish Harbor Wharf, Terminal Island, Los Angeles, California. It purchases raw fish by the ton from fishermen, cans the fish and sells it to customers (who then resell it to consumers) through brokers. [R. 36-37.]

Taxpayer keeps its books and files its tax returns on the basis of the accrual method of accounting and on the basis of fiscal years ending May 31st. Taxpayer filed its corporation income and declared value excess profits tax return and its excess profits tax return for the fiscal year involved, ended May 31, 1943, with the Collector of Internal Revenue for the Sixth District of California. [R. 37.]

Pursuant to the provisions of the Emergency Price Control Act of 1942, the Administrator of the Office of Price Administration (hereinafter designated O. P. A.), issued a General Maximum Price Regulation (hereinafter designated G. M. P. R.), which fixed the price at which taxpayer could sell its canned tuna at the same price at which it had sold them during the month of March, 1942. Taxpayer had not sold fancy light meat tuna during March, 1942, therefore, under the terms of the G. M. P. R. taxpayer was required to adopt as its ceiling price for that commodity the price which was charged during March, 1942, by its nearest competitor. There was disagreement among taxpayer's officials as to who was its nearest competitor. Despite advice from counsel to the contrary, taxpayer adopted the lowest price in the industry, *i.e.,* $11 per case on fancy light meat tuna, basis 48 ½'s. This was the price used by Van Camp Sea Food Company. At the time, the highest price was $14 per case, basis 48 ½'s. This price was used by High Seas Tuna Company of San Diego. [R. 39-40.]

No ceilings were fixed by G. M. P. R. upon the price of raw fish which continued to rise during the year 1942. The widely varying ceiling prices for canned tuna and the lack of a ceiling price for raw fish was recognized in 1942 as inequitable by the officials of O. P. A.

The head of the Fish Section of the O. P. A., Mr. Triggs, proposed to remedy the situation by issuing a regulation fixing the price at which all canners would be required to sell the same product, and also by fixing a ceiling price upon raw fish. [R. 40-41.]

Taxpayer's sales manager, Mr. Williams, kept in constant touch with O. P. A. officials in Washington during the summer and fall of 1942. He made several trips to Washington to confer with Mr. Triggs. Mr. Williams spoke with Mr. Triggs frequently over the telephone and he wrote letters to Mr. Triggs. Mr. Triggs advised Mr. Williams that a new regulation fixing the price at which all canners would be required to sell the same product would be issued momentarily. Mr. Triggs gave Mr. Williams reason to believe that the expected new dollar and cents ceiling price for fancy light meat tuna would be $12 per case, basis 48 ½'s. [R. 41.]

New ceilings were fixed on several canned fish products during the late summer and fall of 1942, but these did not affect canned tuna. While awaiting the new ceiling on canned tuna, taxpayer accumulated a large inventory. Its cash position became relatively low since its cash expenditures averaged approximately $235,000 per week during the sardine season months, October through December. [R. 42-43.]

Taxpayer's sales manager, Mr. Williams, again consulted Mr. Triggs, and was advised that the expected new ceiling on tuna would be issued shortly. The sales manager was also advised that Mr. Triggs would support anything taxpayer might do if it was within reason. Upon advice from counsel, taxpayer, beginning with September 24, 1942, invoiced its customers at $12 per case

of fancy light meat tuna, basis 48 ½'s [R. 43-44] and placed the following notation upon the invoice [R. 44]:

> Please remit in accordance with this invoice. If OPA fails to promulgate an order stabilizing or equalizing prices on the products covered on or before October 31, we agree to revert back to our March ceilings, which are $1.00 per case less on 48/½'s and $2.00 per case less on 48/1's, and will refund you accordingly.

Taxpayer also sent a mimeographed announcement to all its customers on September 24, 1942, explaining its action. Also, on the same day, taxpayer by letter advised Mr. Triggs of the action taken. [R. 44.]

The new regulation on canned tuna was not issued until January 7, 1943, at which time the ceiling price on fancy light meat tuna, basis 48 ½'s, was fixed at $12. Thereafter, the Los Angeles enforcement office of the O. P. A. conducted an investigation of taxpayer's sales of canned tuna during the period from September 24, 1942, until the new regulation was issued Jannary 7, 1943. That office determined that taxpayer had overcharged its customers $97,215 on sales of canned tuna.

After conferences between officials of taxpayer and enforcement officials of the Los Angeles office of the O. P. A., taxpayer's representatives were told that they had violated G. M. P. R. However, in view of the extenuating circumstances, O. P. A. would consider the matter closed if taxpayer would present them with a check in favor of the Treasurer of the United States for the exact amount of the overcharge, as a contribution to the war effort. [R. 44-45.]

The taxpayer made the payment dated May 20, 1943, in the amount of $97,215 to the Treasurer of the United

States. Taxpayer's officers also signed a waiver of answer and consent judgment in an action to restrain future violations, which action was filed by the O. P. A. in the District Court, Southern District of California, June 3, 1943. [R. 45.]

The action of the Los Angeles enforcement officials of O. P. A. in accepting single damages instead of suing for treble damages was approved in Washington by the then Chief of Enforcement of the Meat and Dairy Products Section of the Food Enforcement Branch of O. P. A. Single damages were accepted because it was considered that taxpayer's violation was inadvertent and not wilful; that taxpayer had acted in good faith and had taken reasonable precautions to comply with the law. [R. 45-46.]

Taxpayer on its tax returns for the taxable year involved, fiscal year ended May 31, 1943, deducted the amount of $97,215 as an ordinary and necessary business expense. The Commissioner of Internal Revenue disallowed the amount as a deduction and assessed additional taxes against the taxpayer. The additional tax was paid in July, 1948. [R. 11-12, 38.]

Taxpayer's claim for refund was filed in October, 1949, and when no refund was made, taxpayer commenced this suit in February, 1952. [R. 38.]

Statement of Points to Be Urged.

The statement of points which are relied on by the Government as the basis for these proceedings is set forth at pages 61-62 of the printed record. In substance they are that the District Court erred in that certain of its findings of fact and conclusions of law are not supported by and are contrary to the evidence; that the

District Court erred in failing to find that the taxpayer's violation of the Emergency Price Control Act of 1942, and regulations thereunder, was the result of intentional and wilful acts by the taxpayer; that the District Court erred in failing to find that the allowance as a deduction from gross income of the $97,215 paid by the taxpayer to the Treasurer of the United States as a result of its violation would frustrate the enforcement of the applicable law and regulations and would violate public policy; and that accordingly the District Court erred in entering judgment for the taxpayer.

Summary of Argument.

The amount paid by the taxpayer to the Treasurer of the United States in compromise of a treble damage claim by the O. P. A. under Section 205(e) of the Emergency Price Control Act of 1942, as amended, is not deductible as an ordinary and necessary business expense under Section 23(a)(1)(A) of the Internal Revenue Code of 1939.

A. Whether an expense incurred by reason of violating the Emergency Price Control Act is deductible as an ordinary business expense depends upon whether the deduction will frustrate the purposes of the statute or a sharply defined legislative policy. The purposes of the Act are frustrated if a deduction is allowed where the taxpayer has wilfully violated the Act or has failed to take reasonable practicable precautions against the occurrence of the violation.

B. The burden of showing the right to the claimed deduction is on the taxpayer. This burden the taxpayer has failed to meet.

"Wilful," as used in Section 205(e) of the Emergency Price Control Act, as amended, means knowingly, intentionally and deliberately, as distinguished from accidental or unintentional. No malice or evil intent is necessary. Taxpayer understood the Regulations and knew what the ceiling price was at the time of its overcharge. Taxpayer's act of overcharging was voluntary, deliberate and intentional. Therefore, taxpayer's violation of the Act was wilful.

"Practicable precautions" within the meaning of Section 205(e) of the Emergency Price Control Act of 1942, as amended, are the exercise of ordinary reasonable care to avoid commission of a violation. Taxpayer disregarded principles of ordinary care and wilfully violated the Act despite its full knowledge of the applicable ceilings on its products.

The findings of the trial court with respect to wilfulness, the exercise of practicable precautions, and with respect to whether the allowance of the deduction sought would frustrate the purposes of the Act are not supported by the evidence and are clearly erroneous.

C. The "penalty" test of deductibility has been rejected by this Court.

D. The administrative settlement of the claim for treble damages is not conclusive as to the nature of taxpayer's violation. The administrative determination, if any, of wilfulness or innocence is not binding on this Court since the administrative determination was not the exercise of a judicial or quasi judicial function. Nor was it the legislative intent that the administrative determination should be binding on the courts in a judicial proceeding such as this.

ARGUMENT.

The Amount Paid by the Taxpayer to the Treasurer of the United States in Compromise of a Claim by the O. P. A. Under Section 205(e) of the Emergency Price Control Act of 1942, as Amended, Is Not Deductible as an Ordinary and Necessary Business Expense Under Section 23(a)(1)(A) of the Internal Revenue Code of 1939.

A. The Test for the Deductibility of the Expense Here Incurred Because of a Violation of Law.

Expenses which are incurred because of violating the law are deductible as ordinary and necessary business expenses only if the deduction does not frustrate the purposes of the statute or a sharply defined legislative policy. *Commissioner v. Heininger,* 320 U. S. 467. In that case the Supreme Court stated (pp. 473-474):

> The Bureau of Internal Revenue, the Board of Tax Appeals, and the federal courts have from time to time, however, narrowed the generally accepted meaning of the language used in Section 23(a) in order that tax deduction consequences might not frustrate sharply defined national or state policies proscribing particular circumstances. * * *
>
> If the respondent's litigation expenses are to be denied deduction, it must be because allowance of the deduction would frustrate the sharply defined policies of 39 U. S. C. Sections 259 and 732 which authorize the Postmaster General to issue fraud orders. * * *

This Court adopted the test established by the *Heininger* case when it stated in *National Brass Works v. Commissioner,* 182 F. 2d 526, 580:

> The real reason for denying the deductibility of "penalties" is not that they are characterized as such

> but because allowance in many cases would be against public policy. * * *
>
> Study convinces us that, in these circumstances, an expense is ordinary and necessary if commonly experienced in the community, provided that the expenditure does not frustrate the purposes of a statute or violate public policy. * * *

The test, whether a deduction would frustrate purposes of a statute or violate public policy, is well established and has been applied by the courts to cases involving the deduction, as an ordinary and necessary business expense, of payments to the Treasury of the United States by reason of violating a price ceiling established pursuant to the Emergency Price Control Act. *Commissioner v. Pacific Mills,* 207 F. 2d 177 (C. A. 1st); *Jerry Rossman Corp. v. Commissioner,* 175 F. 2d 711 (C. A. 2d); *American Brewery v. United States,* 223 F. 2d 43 (C. A. 4th); *Nemrow Bros., Inc. v. United States,* 125 F. Supp. 604 (Mass.).

Congress clearly established a sharp national policy by enacting the Emergency Price Control Act of 1942. In Section 1 it was stated that the Act was "necessary to the effective prosecution of the present war." Thus, the Act sought to prevent practices resulting from the abnormal market conditions which would disrupt the national economy, and to establish a stabilization of prices, fair wages and cost of production.

Section 205(e) of the Act (Appendix, *infra*) originally provided simply for a treble damage action against the

violator. If the violation was in good faith, no action could be maintained. (Sec. 205(d).) As amended by Section 108(b) of the Stabilization Extension Act of 1944 (Appendix, *infra*), Section 205(e) then provided that the amount of damages "shall be the amount of the overcharge or overcharges or $25, whichever is greater, if the defendant proves that the violation of the regulation, order, or price schedule in question was neither wilful nor the result of failure to take practicable precautions against the occurrence of the violation."

In determining what would frustrate the purposes of the Act, when the question is the deductibility of a payment made for violation of the Act, the courts have looked to Section 205(e). *Commissioner v, Pacific Mills, supra; Jerry Rossman Corp. v. Commissioner, supra; American Brewery v. United States, supra; Nemrow Bros., Inc. v United States, supra.* If a deduction is allowed in diminution of the effect of this section, then the purposes of the Act would be frustrated. Thus, unless the taxpayer shows circumstances incompatible with intentional or negligent violation of the statute, to allow the deduction would frustrate the purposes of the Act. If the overcharge is knowingly and deliberately made, or without reasonable practicable precautions against an overcharge, it is inconsistent with an innocent, unintentional violation.

B. The Findings of the District Court That the Taxpayer's Violation of the Emergency Price Control Act Was Inadvertent and Not Wilful, That Taxpayer Had Taken Reasonable Precautions to Comply With the Law and That the Allowance of the Deduction Would Not Frustrate the Purposes of the Act nor Violate Public Policy Are Clearly Erroneous.

1. Burden of Proof on the Taxpayer.

The Emergency Price Control Act expressly provided that the violator of the Act was subject to an action for treble damages, except where the taxpayer proved that the violation was neither wilful nor the result of failure to take practicable precautions against the occurrence of the violation. Not only is there clearly imposed upon the taxpayer the burden of proving an unintentional violation, but also the burden of proving that the violation was not the result of a failure to take practicable precautions against the violation. If the burden is sustained, the damages are limited to $25 or the amount of the overcharges, whichever is greater. "Wilful," as used in Section 205(e) means a voluntary and deliberate act as distinguished from accidental, involuntary or unintentional. The word does not require an evil intent or purpose. *Zimberg v. United States,* 142 F. 2d 133 (C. A. 1st), certiorari denied, 323 U. S. 712; *Connor v. Wheeler,* 77 F. Supp. 875 (W. D. Pa.).

Moreover, it is now a "familiar rule that an income tax deduction is a matter of legislative grace and that the burden of clearly showing the right to the claimed deduction is on the taxpayer." *Interstate Transit Lines v. Commissioner,* 319 U. S. 590, 593. See, also, *New Colonial Co. v. Helvering,* 292 U. S. 435, 440; *Deputy v.*

duPont, 308 U. S. 488, 493; *Commissioner v. Jacobson,* 336 U. S. 28, 48-49; *McDonald v. Commissioner,* 323 U. S. 57, 60.

2. The Taxpayer Has Not Adduced Any Evidence to Establish an Innocent and Unintentional Violation After Taking Reasonable Practical Precaution to Prevent a Violation.

(a) *Taxpayer Was Guilty of a Wilful Violation of the Act and Regulations.*

Taxpayer has not contended that the regulations were complex and that it lacked comprehension of them. Some cases have had this element to weigh in appraising the violation. See, *e.g., Jerry Rossman Corp. v. Commissioner, supra; Commissioner v. Pacific Mills, supra.* In this case, taxpayer had a complete understanding of the meaning and effect of the controlling regulations. [R. 134-136, 164, 180.] Yet, taxpayer knowingly, deliberately, and disregarding the controlling regulations charged its customers a price for canned tuna in excess of the ceiling price. Not that the lack of comprehension would excuse the violation; it is of no mitigating effect in this case since that element is entirely absent.

As pointed out, at the time of the violation taxpayer knew the ceiling price controlling its sales. [R. 134-136, 157, 180.] The price was set by G. M. P. R., Section 1499.2. (Appendix, *infra.*) In a case such as this one, where a taxpayer had no ceiling price during the critical period, *i.e.,* during the month of March, 1942, the price charged by the nearest competitor during such month was to be chosen. G. M. P. R., Section 1499.2. While taxpayer chose a low ceiling, $11 [R. 39], such price became its ceiling. [R. 177.] It was not required to choose the lowest price in the industry.

Taxpayer's choice of the lowest price in the industry, although it may have had virtues impertinent to this case, was made after deliberation and contrary to the views of counsel. [R. 39, 114.] Taxpayer elected to ignore the advice of its counsel whose function it was to keep abreast of the law. [R. 131-132.] That taxpayer made a mistake or created a situation in which the equities tear at the heart is unimportant in this case. The District Court recognized taxpayer's inequitable situation. [R. 41.] This Court, however, has very forcibly stated in *National Brass Works v. Commissioner,* 205 F. 2d 104, 106:

> But a claim of inequity cannot justify a violation of an order. Taking the law into its own hands would frustrate the policies of the United States in its effort to prevent wartime inflation.

To extricate itself from an unfavorable situation of its own creation, taxpayer attempted to clothe its violation of the law with the indicia of compliance with the law. Taxpayer had withheld its tuna from the market and accumulated a large inventory until the beginning of September, 1942, when the overcharges were made. [R. 42.] Customers were invoiced at $12, a price above the applicable ceiling. [R. 44.] Taxpayer knew at the time of billing the customers that the $12 price was $1 in excess of the applicable ceiling. [R. 134-136, 156.] Taxpayer admits that it knew the ceiling was $11. [R. 180.] Yet taxpayer intentionally and deliberately continued to invoice its customers at the overceiling price of $12 from September, 1942, to January, 1943. [R. 146, 150, 156.] Taxpayer intended that each of the customers pay the $12 price knowing that such price was in excess of the ceiling. [R. 135, 136.] The charges were made while G. M. P. R.

was in effect and taxpayer's ceiling was $11. [R. 177.] Its course of conduct clearly shows that taxpayer's actions were voluntary and with full knowledge of the law. Therefore, taxpayer intentionally, knowingly and deliberately violated G. M. P. R. at the time of its acts of selling and charging its customers $12 per case, basis 48 ½'s, from September, 1942, to January, 1943.

In an analogous case, *Batson v. Porter,* 154 F. 2d 566 (C. A. 4th), the court held that taxpayer's violation of the ceiling prices was wilful. There, taxpayer, a wholesaler of meat, sold meats in excess of the ceiling prices established by maximum price regulations. Taxpayer knew that the prices exceeded the ceiling, and notified its customers of the overcharge. However, taxpayer contended that the excess prices charged were necessary in order that it continue its business. In holding the violation wilful, the court stated (p. 568):

> It is obvious that the defendant was not authorized to substitute his judgment for that of the administrator and to sell his product to retail dealers above the authorized ceiling price merely because he believed that the retail dealers would absorb the excess and would not in turn violate the regulations in making their retail sales.

The factual differences between the *Batson* case and this case are not sufficient to support a distinction. The contention in the *Batson* case that the charges were necessary in order that that taxpayer continue its business created merely an equity and could not vitiate taxpayer's violation. There were procedures established for seeking an adjustment of the maximum price regulations. Taxpayer in this case, however, has similarly urged its economic position [R. 13, 40, 42-43] and similarly sub-

stituted its judgment for that of the administrator instead of requesting, as we will discuss, *infra,* an adjustment in the ceiling prices in accordance with the established procedures.

On the basis of the undisputed evidence on this case, it is therefore contended that the District Court was clearly in error in failing to find that taxpayer intentionally, knowingly and deliberately charged prices for its canned tuna in excess of the maximum ceiling regulations and thereby wilfully violated the Emergency Price Control Act.

(b) *Taxpayer Did Not Take Practicable Precautions Against the Occurrence of the Violation.*

What taxpayer did to give the appearance of complying with the law and the regulations is of no avail in this case. On its invoices, with the advice of counsel, taxpayer included the following notation [R. 14, 44]:

> Please remit in accordance with this invoice. If OPA fails to promulgate an order stabilizing or equalizing prices on the products covered on or before October 31st, we agree to revert back to our March ceilings, which are $1.00 per case less on 48/½'s and $2.00 per case on 48/1's, and will refund you accordingly.

The notation does not prove taxpayer did not intend to violate the statute. It was always the taxpayer's intention and expectation to be paid $12 under the invoice. [R. 134-136.] That price was $1 in excess of taxpayer's ceiling price. The notation was merely one of a series of acts employed by the taxpayer to give its conduct the color of complying with the law. Moreover, the taxpayer did not even adhere to the notation; for it continued to invoice its customers at the overceiling price of $12 after the October 31st date mentioned therein.

By invoicing in the manner taxpayer did, it intended to violate the price ceiling and was taking a gamble on the results. During the summer and fall, 1942, new regulations set a higher ceiling upon several canned fish products but did not include the type of canned tuna involved. [R. 42.] Taxpayer set October 31, 1942, as the date it was gambling upon for its higher ceiling [R. 14, 44], when, in fact, the new regulations setting a different and higher ceiling price on the type of canned tuna involved were not issued until January 7, 1943. [R. 44.] Taxpayer knowingly and deliberately chose to gamble on the results of its action but having lost the gamble, now contends its acts in violation of the statute were not intentional, but innocent and unintentional after having taken practicable precautions. "Practicable precautions" within the meaning of Section 205(e) are the exercise of ordinary, reasonable care to avoid commission of the violation. *Cobleigh v. Wood,* 172 F. 2d 167 (C. A. 1st), certiorari denied, 337 U. S. 924. To gamble on the issuance of the regulation, or when issued, that it would be retroactive to September, 1942, so as to justify the overcharge, is clearly a lack of reasonable practicable business precaution against violating the Emergency Price Control Act.

The taxpayer's sales manager, Mr. Williams, had conferences with Mr. Triggs, head of the Fish Section, O. P. A., Washington, and wrote several letters to him. The District Court found that Mr. Triggs was sympathetic to taxpayer, recognizing its bad position. [R. 41, 81.] The court also found that Mr. Triggs advised the sales manager that a new regulation was "expected" to set a new ceiling of $12 on the type of fancy tuna involved and that such regulation "could be expected momentarily."

[R. 41.] However, as a reasonably prudent business man, taxpayer's sales manager knew that the advice given was informal and was not an official opinion. Mr. Triggs only advised taxpayer in a general manner and denied that he authorized taxpayer to charge a price in excess of its ceiling. [R. 84, 85, 87, 159-161.] Furthermore, Mr. Triggs knew that he had no authority to grant taxpayer special permission to charge prices in excess of the ceiling. [R. 159, 177.] Although Mr. Triggs agreed with Mr. Williams that taxpayer's ceiling price was low, Mr. Triggs denied that he authorized an increase in price or that he led Mr. Williams to believe that the overcharge would not be a violation. [R. 159, 172-173, 177-178.] Taxpayer asserts innocence by reason of reliance on the informal advice. This Court, however, has held that the violation was wilful even where taxpayer made formal application for an adjustment in ceiling prices, but without permission anticipated the adjustment and charged excess prices. *Porter v. Crawford & Doherty Foundry Co.*, 154 F. 2d 431, certiorari denied, 329 U. S. 720.

The G. M. P. R. established the method whereby any person aggrieved by the ceiling price could seek relief. Section 1499.19 thereof provides (Appendix, *infra*):

> *Petitions for amendment.* Any person seeking a modification of any provision of this General Maximum Price Regulation, or an adjustment not provided for in Sec. 1499.18 of this General Maximum Price Regulation, may file a petition for amendment in accordance with the provisions of Procedural Regulation No. 1 issued by the Office of Price Administration.

The procedure for seeking adjustment was established by Procedural Regulation No. 1, 7 Fed. Register 971. Tax-

payer chose to ignore the procedures and sought informal advice which it now contends was the exercise of practicable precaution. On the contrary, the practicable course was to seek an adjustment in accordance with the established procedures. If that course had been taken, it may have resulted in official permission to charge the price requested in the application for adjustment. (See O. P. A. policy, *e.g.,* Maximum Price Regulation No. 299, Sec. 1364.652 (Appendix, *infra*); Maximum Price Regulation No. 124, Sec. 1303.253, 7 Fed. Register 3158; Temporary Maximum Price Regulations No. 22, Sec. 1351.805, 7 Fed. Register 7915.) No general adjustable pricing, however, was permitted under the G. M. P. R.

All of taxpayer's maneuvers to give its conduct the color of compliance with the law are not enough to sustain the burden of proving that the violation was not intentional and deliberate, and was after taking reasonable practicable precautions against the occurrence of a violation. As pointed out, the evidence clearly establishes that when overcharges were made, taxpayer knew that its ceiling was $11. Nevertheless, taxpayer intentionally, knowingly and deliberately charged its customers $12 which was $1 in excess of the ceiling price. It is no excuse to intentional and deliberate conduct that taxpayer sought the advice of an official of the O. P. A. in Washington. No official authority or advice was given to justify taxpayer's conduct. The law and regulations were clear at the time of taxpayer's conduct; no unofficial action could change them. Therefore, even if taxpayer relied on an informal and unofficial opinion, it does not excuse taxpayer's intentional violation of the Act, since reliance was not reasonable practicable precaution. Hence, taxpayer's intentional conduct in seeking a price for its canned

tuna in excess of the known ceiling constituted a wilful violation of the Emergency Price Control Act.

As we have noted, Section 205(e) of the Act expressly provides that the amount of damages shall be limited to $25 or the amount of the overcharge, whichever is greater, but only if the defendant proves that the violation was neither wilful nor the result of failure to take practicable precautions against the occurrence of a violation. To allow a deduction when taxpayer has not shown that the violation was neither wilful nor the result of a failure to take practicable precaution against the occurrence of a violation causes a diminution of the effect of the statute. The allowance of the deduction under such circumstances thwarts the accomplishment of the policy of the Act, since the purpose of the reduced penalty was to relieve only innocent violators from the possible severity of the full penalty (treble damages) imposed by the Act. 90 Cong. Record, Part 4, pp. 5375-5384, 5435-5451; 90 Cong. Record, Part 5, pp. 5886-5887. If taxpayer cannot prove its innocence, the requirements of the relief proviso are not met. In such case, therefore, to allow the deduction constitutes a frustration of the purposes of the Act. *George Schaefer & Sons v. Commissioner,* 209 F. 2d 440 (C. A. 2d); *Henry Watterson Hotel Co. v. Commissioner,* 194 F. 2d 539 (C. A. 6th).

In view of the foregoing we respectfully submit that the findings of the District Court that the taxpayer's violation of the Emergency Price Control Act was not wilful, that taxpayer took reasonable precautions to comply with the law and that the allowance of the deduction in question would not frustrate the purpose of the Act nor violate public policy are not supported by the evidence and are clearly erroneous.

C. Whether the Payment Constituted a Penalty Is Not Determinative of the Issue Presented.

The District Court found that the payment by taxpayer of the amount of the overcharge did not constitute a penalty. [R. 46.] Whether the payment constituted a penalty is not determinative in these cases of price violations, therefore, the penalty test does not apply. This Court has expressly rejected the penalty test as it stated in *National Brass Works, supra* (pp. 529-530):

> While it would perhaps be convenient to attach a tag or label to civil liability for price violations, to do so by the use of the term "penalty" confuses more than it simplifies. What is considered a penalty differs with circumstances and viewpoints. That a payment was or was not in the nature of a penalty would give no quick or sound answer to deductibility. * * *
>
> The real reason for denying the deductibility of "penalties" is not that they are characterized as such but because allowance in many cases would be against public policy. * * *

But even if the determination of the nature of the payments were crucial, the payments in price violation cases under Section 205(e) would constitute penalties as this Court also observed in the *National Brass* case, *supra* (p. 530):

> However, if we had to decide the nature of damage payments to the government under Section 205(e), we would liken them to penalties for the reasons expressed in *Porter v. Montgomery,* 3 Cir., 1947, 163 F. 2d 211. We doubt that 205(e) was in any respect intended to provide for restitution.

D. Administrative Action Is Neither Conclusive nor Binding as Far as a Resolution of the Issue Here Presented Is Concerned.

The fact that O. P. A. accepted merely the amount of overcharges in settlement of the claim for violation is not conclusive as to the nature of taxpayer's violation. *National Brass Works v. Commissioner,* 205 F. 2d 104 (C. A. 9th). The administrator settled claims for the amount of the overcharges not only in cases of nonwilful violation but also as a matter of policy to avoid litigation. [R. 160, 161.] Both courses are permissible under the Emergency Price Control Act. *National Brass Works, supra.* The administrator is not required by Section 205 (e) to collect treble damages in each case, even if the violation was intentional. Section 205(e) only sets the maximum amount of damages at 3 times the overcharges. *Cobleigh v. Woods,* 172 F. 2d 167 (C. A. 1st), certiorari denied, 337 U. S. 924. Thus, the administrator may settle the claim for less than treble, or even the amount of the overcharges in a case of intentional violation, or less than treble damages may be awarded by the court. See, *e.g., Porter v. Gray,* 158 F. 2d 442 (C. A. 9th); *Sobel Corrugated & Wooden Box Co. v. Fleming,* 165 F. 2d 568 (C. A. 6th), certiorari denied, 334 U. S. 815. Therefore, despite the limiting provision of Section 205(e), the fact that O. P. A. accepted only the amount of the overcharges in settlement of the claim is as consistent with wilfulness as with innocence.

But even assuming, *arguendo,* that the basis of the administrative action in settling the claim for the amount of the overcharges was O. P. A.'s determination that taxpayer's violation was not wilful, such a determination is not binding on this Court as a criterion of the deducti-

bility as a business expense. *Commissioner v. Heininger, supra.* The doctrine of *res judicata* has no application because the administrative action was not judicial in nature but executive. There was no hearing or contest in this case but simply the administrative exercise of a ministerial determination. The administrative action must be judicial in nature for the principles of *res judicata* or collateral estoppel to apply. See, *e.g., Arizona Grocery v. Atchison Ry.,* 284 U. S. 370; *District of Columbia v. Cluss,* 103 U. S. 705.

The jurisdiction of the District Court and this Court in the instant type of case is invoked not to review the correctness of O. P. A.'s administrative determination, but to adjudicate in the first instance the nature of taxpayer's violation. In *George Schaefer & Sons v. Commissioner,* 209 F. 2d 440 (C. A. 2d), the only issue was whether settlement by O. P. A. of an overcharge claim proved that the violation was innocent so that the allowance of a tax deduction for the settlement payment would not frustrate the purpose of the Emergency Price Control Act. The court stated (pp. 441-442):

> Had taxpayer been sued by OPA, and had there resulted in that suit a judicial decision that taxpayer had successfully defended under the so-called Chandler Amendment, 50 U. S. C. Appendix, Sec. 925(e) —*i.e.,* that the recoverable amount "shall be the amount of the overcharge or overcharges if the defendant proves that the violation of the regulation, order, or price schedule in question was neither willful nor the result of failure to take practicable precautions against the occurrence of the violation"— the result here might have been different. See *Utica Knitting Co. v. Shaughnessy,* D. C., 100 F. Supp. 245. But the mere fact of a settlement cannot be

> deemed the same as a judicial determination; nor (for reasons already stated) can it be given the rank of an administrative determination of innocence.
> * * *

Furthermore, the Emergency Price Control Act makes no provision for the finality or conclusiveness of a determination by the administrator with respect to the nature of a violation. (*Cf.* conclusive provisions of these Acts: Sec. 204, Packers and Stockyards Act, 1921, c. 64, 42 Stat. 159 (7 U. S. C. 1952 ed., Sec. 194); Sec. 6(a) and (b), Commodity Exchange Act, c. 369, 42 Stat. 998 (7 U. S. C. 1952 ed., Secs. 8, 9); Secs. 501 and 515, Tariff Act of 1930, c. 497, 46 Stat. 590 (19 U. S. C. 1952 ed., Secs. 1501, 1515); Sec. 5, Federal Trade Commission Act, c. 311, 38 Stat. 717, as amended (15 U. S. C. 1952 ed., Sec. 45).) The administrator is empowered by Section 205(e) to institute an action in the courts for the recovery of damages, if he deems there has been a violation. However, a corollary of that authority is the power to make administrative or executive determinations relative to the violation. Thus, the administrator may prosecute the claim in the courts or settle it as the best interests of the Government dictate. As previously shown, there inheres no incidental effects of *res judicata* in this function of the administrator. Any determination by the administrator without an assertion of the claim in the courts and an adjudication on the merits therein is not an action which under the statute could have a conclusive effect upon the courts. It is therefore apparent that the legislative intent inferred from the statute is that Congress did not intend that an administrative determination with respect to the nature of a violation be binding or

conclusive against the courts in a judicial proceeding such as this.

From the foregoing it is clear that in cases of this type the courts concerned clearly have the jurisdiction to determine on the merits the nature of taxpayer's violation. *Jerry Rossman Corp. v. Commissioner, supra.*

Conclusion.

The decision of the District Court is clearly wrong and therefore should be reversed.

Respectfully submitted,

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APPENDIX.

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) [As amended by Sec. 121(a) of the Revenue Act, Act of 1942, c. 619, 56 Stat. 798] *Expenses.*—

(1) *Trade or Business Expenses.*—

(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

* * * * * * * *

(26 U. S. C., 1952 ed., Sec. 23.)

Emergency Price Control Act of 1942, c. 26, 56 Stat. 23:

SEC. 205 * * *

* * * * * * * *

(e) If any person selling a commodity violates a regulation, order, or price schedule prescribing a

maximum price or maximum prices, the person who buys such commodity for use or consumption other than in the course of trade or business may bring an action either for $50 or for treble the amount by which the consideration exceeded the applicable maximum price, whichever is the greater, plus reasonable attorney's fees and costs as determined by the court. For the purposes of this section the payment or receipt of rent for defense-area housing accommodations shall be deemed the buying or selling a commodity, as the case may be. If any person selling a commodity violates a regulation, order, or price schedule prescribing a maximum price or maximum prices, and the buyer is not entitled to bring suit or action under this subsection, the Administrator may bring such action under this subsection on behalf of the United States. Any suit or action under this subsection may be brought in any court of competent jurisdiction, and shall be instituted within one year after delivery is completed or rent is paid. The provisions of this subsection shall not take effect until after the expiration of six months from the date of enactment of this Act.

* * * * * * * *

(50 U. S. C. Appendix, 1940 ed., Supp. III, Sec. 925.)

Stabilization Extension Act of 1944, c. 325, 58 Stat. 632:

SEC. 108. * * *

* * * * * * * *

(b) Subsection (e) of section 205 of the Emergency Price Control Act of 1942, as amended, is amended to read as follows:

"(e) If any person selling a commodity violates a regulation, order, or price schedule prescribing a maximum price or maximum prices, the person who buys such commodity for use or consumption other than in the course of trade or business may, within one year from the date of the occurrence of the violation, except as hereinafter provided, bring an action against the seller on account of the overcharge. In such action, the seller shall be liable for reasonable attorney's fees and costs as determined by the court, plus whichever of the following sums is the greater: (1) Such amount not more than three times the amount of the overcharge, or the overcharges, upon which the action is based as the court in its discretion may determine, or (2) an amount not less than $25 nor more than $50, as the court in its discretion may determine: *Provided, however,* That such amount shall be the amount of the overcharge or overcharges or $25, whichever is greater, if the defendant proves that the violation of the regulation, order, or price schedule in question was neither wilful nor the result of failure to take practicable precautions against the occurrence of the violation. For the purposes of this section the payment or receipt of rent for defense-area housing accommodations shall be deemed the buying or selling of a commodity, as the case may be; and the work 'overcharge' shall mean the amount by which the consideration exceeds the applicable maximum price. If any person selling a commodity violates a regulation, order, or price schedule prescribing a maximum price or maximum prices, and the buyer either fails to institute an action under this sub-

section within thirty days from the date of the occurrence of the violation or is not entitled for any reason to bring the action, the Administrator may institute such action on behalf of the United States within such one-year period. If such action is instituted by the Administrator, the buyer shall thereafter be barred from bringing an action for the same violation or violations. Any action under this subsection by either the buyer or the Administrator, as the case may be, may be brought in any court of competent jurisdiction. A judgment in an action for damages under this subsection shall be a bar to the recovery under this subsection of any damages in any other action against the same seller on account of sales made to the same purchaser prior to the institution of the action in which such judgment was rendered."

(c) The amendment made by subsection (b), insofar as it relates to actions by buyers or actions which may be brought by the Administrator only after the buyer has failed to institute an action within thirty days from the occurrence of the violation, shall be applicable only with respect to violations occurring after the date of enactment of this Act. In other cases, such amendment shall be applicable with respect to proceedings pending on the date of enactment of this Act and with respect to proceedings instituted thereafter.

* * * * * * * *

(50 U. S. C. Appendix, 1940 ed., Supp. IV, Sec. 925.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

> SEC. 29.23(a)-1. *Business Expenses.*—Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, except the classes of items which are deductible under sections 23(b) and 23(z), inclusive, and the regulations thereunder. Double deductions are not permitted. Amounts deducted under one provision of the Internal Revenue Code cannot again be deducted under any other provision thereof. * * * Penalty payments with respect to Federal taxes, whether on account of negligence, delinquency, or fraud, are not deductible from gross income. * * *

General Maximum Price Regulation, 17 Fed. Register 3153:

> Sec. 1499.1 *Prohibition against dealing in commodities or services above maximum prices.* On and after the effective date of this General Maximum Price Regulation, regardless of any contract or other obligation:
>
> (a) No *person* shall *sell* or supply any *service, commodity,* and no person shall sell or supply any at a price higher than the maximum price permitted by this General Maximum Price Regulation; and
>
> (b) No person in the course of trade or business shall buy or receive any commodity or service at a price higher than the maximum price permitted by this General Maximum Price Regulation.

Sec. 1499.2 *Maximum prices for commodities and services; General provisions.* Except as otherwise provided in this General Maximum Price Regulation, the *seller's* maximum price for any commodity or service shall be:

(a) *In those cases in which the seller dealt in the same or similar commodities or services during March 1942:*

The highest price charged by the seller during such month—

(1) For the same commodity or service; or

(2) If no charge was made for the same commodity or service, for the similar commodity or service, most nearly like it; or

(b) *In those cases in which the seller did not deal in the same or similar commodities or services during March 1942:*

The highest price charged during such month by the most closely competitive seller of the same class—

(1) For the same commodity or service; or

(2) If no charge was made for the same commodity or service, for the similar commodity or service most nearly like it.

* * * * * * * *

Sec. 1499.4 *Supplemental regulations.* If the maximum prices established for any commodity under the provisions of this General Maximum Price Regulation fail equitably to distribute returns from the sale at retail of such commodity among producers,

manufacturers, wholesalers and retailers, the Price Administrator will by supplementary regulation establish such maximum prices for different classes of sellers, or fix such base periods for the determination of their maximum prices, as will insure that each such class of sellers shall receive a fair share of such return.

* * * * * * * *

Sec. 1499.17 *Penalties.* Persons violating any provision of this General Maximum Price Regulation are subject to the criminal penalties, civil enforcement actions, and suits for treble damages provided for by the Emergency Price Control Act of 1942, and proceedings for the suspension of licenses.

* * * * * * * *

Sec. 1499.19 *Petitions for amendment.* Any person seeking a modification of any provision of this General Maximum Price Regulation, or an adjustment not provided for in Sec. 1499.18 of this General Maximum Price Regulation, may file a petition for amendment in accordance with the provisions of Procedural Regulation No. 1 issued by the Office of Price Administration.

* * * * * * * *

Sec. 1499.21 *Effect of other price regulations.* This General Maximum Price Regulation shall not apply to any sale or delivery for which a maximum price is in effect, at the time of such sale or delivery, under the provisions of any other price regulation issued, or which may be issued, by the Office of Price Administration.

Sec. 1499.22 *Applicability.* The provisions of this General Maximum Price Regulation shall be applicable to the United States, its territories and possessions, and the District of Columbia.

Sec. 1499.23 *Effective date.* All the provisions of this General Maximum Price Regulation shall become effective on May 11, 1942, except that:

(a) The provisions of this General Maximum Price Regulation, other than Sec. 1499.11(a), shall not apply to establishments selling at retail until May 18, 1942;

(b) The provisions of Secs. 1499.1 and 1499.2 shall not apply to any sale of services at retail until July 1, 1942; and

(c) The provisions of Sec. 1499.11(a) shall become effective upon the date of issuance of this General Maximum Price Regulation.

Maximum Price Regulation No. 299, 8 Fed. Register 364:

Sec. 1364.651. *Prohibition against dealing in tuna, bonito, and yellowtail at prices above the maximum.* On or after January 13, 1943, regardless of any contract, agreement or other obligation, no canner, or agent or other person acting on behalf, or under control, of such canner shall sell or deliver any tuna, bonito, or yellowtail, and no person in the course of trade or business shall buy or receive from a canner any tuna, bonito, or yellowtail at prices higher than those set forth in Appendix A hereof, incorporated herein as Sec. 1364.662; and no person shall agree, offer, solicit, or attempt to do any of the foregoing.

The provisions of this section shall not be applicable to sales or deliveries of tuna, bonito, and yellowtail to a purchaser if prior to January 13, 1943, such tuna, bonito, or yellowtail has been received by a carrier, other than a carrier owned or controlled by the seller, for shipment to such purchaser.

Sec. 1364.652. *Conditional agreement.* No canner of tuna, bonito, or yellowtail shall enter into an agreement permitting the adjustment of the prices to prices which may be higher than the maximum prices provided by Sec. 1364.662 in the event that this Maximum Price Regulation No. 299 is amended or is determined by a court to be invalid or upon any other contingency: Provided, That if a petition for amendment has been duly filed, and such petition requires extensive consideration, the Administrator may grant an exception from the provisions of this section permitting the making of contracts adjustable upon the granting of the petition for amendment.

Sec. 1364.655. *Evasion.* The price limitations set forth in this Maximum Price Regulation No. 299 shall not be evaded, whether by direct or indirect methods, in connection with an offer, solicitation, agreement, sale, delivery, purchase, or receipt of, or relating to tuna, bonito or yellowtail, alone or in conjunction with any other commodity, or by way of any commission, service, transportation, or other charge, or discount, premium, or other privilege, or by tying-agreement or other trade understanding, or by changing the selection or style of processing or the canning, wrapping or packaging of tuna, bonito or yellowtail.

Sec. 1364.657. *Enforcement.* (a) Persons violating any provision of this Maximum Price Regulation No. 299 are subject to the criminal penalties, civil enforcement actions, and suits for treble damages provided for by the Emergency Price Control Act of 1942, as amended.

* * * * * * * *

Sec. 1364.658. *Petition for amendment.* Any person seeking an amendment of any provision of this Regulation No. 299 may file a petition for amendment in accordance with the provisions of Revised Procedural Regulation No. 1 issued by the Office of Price Administration.

Sec. 1364.661. *Effective date.* This Maximum Price Regulation No. 299 (Secs. 1364.651 to 1364.-662, inclusive) shall become effective January 13, 1943.

Sec. 1364.662. *Appendix A: Maximum canner's prices for* Tuna, Bonito, and Yellowtail. (a) The prices set forth below are maximum prices per case f. o. b. car at the shipping point nearest cannery. The maximum prices are gross prices and the seller shall deduct therefrom his customary allowances, discounts, and differentials to purchasers of different classes.

Variety	Style of container and price per case 1 lb. Tuna	½ lb. Tuna	¼ lb. Tuna
Albacore:			
Fancy	$31.00	$16.00	$9.00
Standard	27.00	14.00	8.00
Grated	25.00	13.00	7.50
Flake	25.00	13.00	7.50
Light Meat:			
Fancy	23.00	12.00	7.00
Standard	21.00	11.00	6.50
Grated	19.70	10.35	6.20
Flake	19.00	10.00	6.00
Bonito:			
Standard	17.00	9.00	5.50
Flake	15.00	8.00	5.00
Yellowtail:			
Standard	16.00	8.50	5.25
Flake	14.00	7.50	4.75